

17 March 2022

Ms Stephanie Jolly  
General Manager, Market Performance  
Australian Energy Regulator  
GPO Box 3131  
Canberra ACT 2601

Via email: [dmo@aer.gov.au](mailto:dmo@aer.gov.au)

Dear Ms Jolly

Tango Energy welcomes the opportunity to provide its views and feedback on the Australian Energy Regulator's (AER) Draft Default Market Offer Determination (DMO) for 2022-23. With regard to the proposed changes in the AER's approach to determining the DMO, the following submission:

- firstly, evaluates the AER's cost stack and wholesale hedging assumptions;
- secondly, assesses the market and consumer implications of providing inadequate pricing flexibility and headroom; and
- finally, calls on the AER to work collaboratively with the Commonwealth Government to introduce any changes to the DMO methodology in a planned and coordinated manner.

## 1. Cost stack and hedging assumptions

Tango Energy does not agree with the AER's Draft Determination to adopt a cost-build-up approach, and considers that the AER's justifications for moving to the cost-build up approach remain unclear. It must be acknowledged that price regulation is not a perfect substitute for market-based outcomes and can only provide indicative pricing at best. With this in mind, Tango Energy questions why the AER is creating additional complexity in its price determination methodology by proposing to develop a retail cost stack. Adopting a cost stack approach not only increases the likelihood of inadvertent cost miscalculations, but also makes the setting of standing offer prices reliant on cost-based assumptions that may understate the actual costs incurred by smaller retailers that have not attained economies of scale.

Further, there does not appear to be any credible reason for moving from the 95<sup>th</sup> percentile to the 75<sup>th</sup> percentile in determining hedged wholesale electricity costs (WEC). Even ACIL Allen in its advice to the AER 'remains of the view that adopting a risk averse strategy is appropriate' observing that 'estimating the WEC inherently involves a degree of uncertainty. Adopting a high percentile estimate from the simulations as the final estimate of the WEC minimises the risk of underestimating the true value of the WEC.'<sup>1</sup> Indeed, as the DMO is not meant to represent an efficient price but rather a safety net, it seems more appropriate for a conservative approach to be adopted to ensure there is minimal residual risk being borne by electricity retailers.

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<sup>1</sup> ACIL Allen, *Default Market Offer 2022-23 Wholesale Energy and Environment Cost Estimates for DMO 4 Draft Determination*, 23 February 2022, p 34.

It should also be kept in mind that as consumers have no real incentive to take up market offers that are priced higher than the DMO, the DMO effectively operates as a market price cap. This means if an aggressive standing offer price cap is imposed, it could further inhibit the ability of smaller retailers to shore up their long-term viability. In particular, the AER's current approach may end up disproportionately affecting smaller retailers who do not have a natural generation hedge.

## **2. Market and consumer implications**

Despite observations that 'a number of smaller retailers have market offers in the DMO regions well below the DMO price, despite not having achieved the economies of scale of larger retailers',<sup>2</sup> many smaller retailers use pricing penetration strategies in order to attract customers and build their retail book. Over time the prices of smaller retailers may inevitably need to rise to achieve long-term sustainability. However, if standing offer prices do not provide for adequate cost allowances, it could dilute investment signals for new entrants and constrain overall pricing flexibility thereby making it harder for smaller retailers to compete. This could, in turn, lead to a diminishment of market competition and further entrench the incumbent positions of the market's largest retailers. Such outcomes would not be in the long-term interests of energy consumers, as it is primarily smaller retailers that are disrupting traditional retail models and leading the transition away from thermal generation. Further, such an outcome would also detract from one of the DMO's primary objectives, which is to maintain incentives for competition amongst consumers as well as incentives for consumers to engage in the market. With this in mind, the AER must balance the need to safeguard disengaged consumers from high electricity costs with the need to provide sufficient pricing flexibility to stimulate continued investment and innovation.

While Tango Energy acknowledges that vulnerable customers should not be paying too much for electricity, there are other means of achieving this end where vulnerable customers can be assisted in a more targeted and effective manner without damaging the broader retail market. For instance, rather than using blunt interventions and compressing standing offer cost stacks, policymakers and regulators alike should be critically evaluating how they can encourage vulnerable customers to move away from standing offers. This could be as simple as requiring retailers to inform vulnerable customers that a better electricity plan is available, similar to the approach adopted under the NSW Social Programs for Energy Code.<sup>3</sup>

## **3. Certainty and consistency**

With respect of broader government policy, Tango Energy also observes that the Australian Government Department of Industry, Science, Energy and Resources is yet to finalise its review of the DMO framework. In view of this, Tango Energy questions the timing of the AER making substantial reforms to its methodology, including changing small business usage assumptions from 20,000 to 10,000 KWh per year.

Tango Energy considers that it would be more pragmatic and logical for all proposed changes to the DMO framework to be made at the same time. Adjusting usage assumptions and other aspects in determining the DMO prices is resource and time intensive. Further, any significant changes to the DMO framework need to be adequately communicated to avoid consumer confusion.

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<sup>2</sup> Australian Energy Regulator, Default Market Offer Prices 2022-23 Draft Determination, February 2022, p 34.

<sup>3</sup> See *NSW Social Programs for Energy Code*, 1 November 2021, cl A.6.1.

With this in mind, Tango Energy encourages the AER to work closely with the Australian Government in administering any changes to the DMO framework as a suite of reforms to be implemented in 2023-24 as part of DMO 5. Moreover, given that usage profiles are only indicative and will never be entirely reflective of an individual customer's consumption patterns, Tango Energy questions whether it is necessary and cost efficient to update DMO usage profiles each year as proposed by the AER.

### **Concluding remarks**

While Tango Energy acknowledges that the AER is unlikely to reverse its decision and adopt a cost indexation approach in setting future DMO determinations, Tango Energy encourages the AER to embrace simplicity where possible. It is ultimately imperative that the DMO remains a mere safety net and is not repositioned to serve as a proxy price cap to impose perceived notions of efficiency on electricity retailers, as the market requires continued pricing flexibility to innovate and adapt to a greener and less carbon intensive tomorrow.

If the AER would like to discuss Tango Energy's views on the Draft Determination in further detail, please email [aoconnell@tangoenergy.com](mailto:aoconnell@tangoenergy.com) or call (03) 8621 6309.

Yours sincerely

A handwritten signature in black ink, appearing to read 'A. O'Connell', with a stylized flourish at the end.

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